No. 15982

In the United States Court of Appeals for the Ninth Circuit

LESLY COHEN, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 206-248) are not officially reported.

JURISDICTION

This appeal involves deficiencies in individual income taxes and statutory additions thereto (50% fraud penalties) as redetermined by the Tax Court in the aggregate sums of $168,533.92 and $91,127.42, respectively, totaling $259,661.34, plus interest according to law, for the three taxable years 1948-1950.[1] (R. 249.)

[1] The Tax Court's redetermination resulted in a total decrease of $1,530,605.43 in the taxpayer's income tax and fraud penalty liabilities for the three years involved, the Commissioner having initially determined and asserted against him deficiencies in income taxes and fraud penalties in the aggregate sums of $1,193,511.18 and $596,755.59, respectively, totaling $1,790,266.77, for those years. (R. 7-12, 207.)

On November 25, 1952, the Commissioner of Internal Revenue mailed to the taxpayer a notice of deficiencies in the total amount of $1,790,266.77 for those years. (R. 7-12.) Within ninety days thereafter, and on March 4, 1958, the taxpayer filed a petition with the Tax Court for a redetermination of those deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. (R. 3-12.) The decision of the Tax Court redetermining the deficiencies in the total amount of $259,661.34 was entered on December 12, 1957. (R. 249.) The case is brought to this Court by the taxpayer's petition for review filed on March 4, 1954. (R. 250-257, 264.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the Tax Court properly held that the Commissioner, in the absence of any *available* and/or adequate books or records kept by the taxpayer clearly showing income for the three taxable years 1948-1950 as required by law, correctly computed the taxpayer's taxable net income and the resulting deficiencies in income taxes for those years—to the extent redetermined by it—by the use of the so-called bank deposit method, under the provisions of Sections 22(a), 41 and 54(a) of the Internal Revenue Code of 1939.

2. Whether the Tax Court correctly found that part of the deficiencies in income taxes, as determined and asserted variously against the taxpayer by the Commissioner, was—to the extent redetermined by it—due to fraud with intent to evade the payment of income taxes for each of the taxable years 1948-1950, under the provisions of Section 293(b) of the 1939 Code.

STATUTES AND REGULATIONS INVOLVED

These are printed in the Appendix, *infra*.

STATEMENT

The facts, including those stipulated by the parties (R. 257-262) and incorporated in its findings of fact (R. 207), were found by the Tax Court substantially as follows (R. 207-221):[2]

Petitioner Lesly Cohen (hereinafter called the taxpayer), during the three taxable years 1948-1950 involved herein, resided in San Francisco, California, and was unmarried. He filed his individual tax returns for the calendar years 1948 through 1950 on a cash basis with the then Collector of Internal Revenue for the First District of San Francisco, California. (R. 207-208.)

The taxpayer was born and educated in San Francisco. He worked on a local newspaper, the San Francisco Bulletin, as a copy boy, and eventually became a sports writer and member of the sports staff. About 1934, when the Bulletin was sold to another publisher, he became a free-lance writer on sports subjects, editing boxing magazines and doing publicity work for various athletic events. (R. 208.)

During the taxable years in question, taxpayer lived modestly in his mother's home with two brothers and two sisters. During World War II, he was inducted into the United States Army. Upon his discharge, he returned to California and soon thereafter became ac-

[2] The facts relating to the issue in respect of certain of the taxpayer's losses from gambling allowed by the Tax Court to the extent of his gambling gains (R. 219-220, 229)—not appealed by the Commissioner—are included herein the more clearly to show the complete picture as to the other issues involved upon review.

quainted with one Coplin, a so-called "betting commissioner", who owned and operated the Kingston Club (111 Ellis Street), in San Francisco. A "card room" was maintained as part of the club's operations. The same premises were used by Coplin for his "betting commissioner" business, which consisted largely of placing bets on horse races on a commission basis. The latter venture was in violation of both State and local law. Coplin, desirous of expanding his gambling activities to embrace other athletic events, invited the taxpayer to join his betting commissioner enterprise as a limited partner. (R. 208.)

In the latter part of 1947, Coplin died, and about January, 1948, the taxpayer took over the operation of the Kingston Club. Thereafter, until the latter part of 1951, when the Federal gambling stamp tax law was put into effect, the taxpayer operated the club's card room and betting commissioner activities as sole proprietor. During the years 1948, 1949 and 1950, his activities as betting commissioner included not only horse racing but other sports events. He was unable to estimate what proportion of the bets handled by him grew out of horse racing and what proportion out of other sports events. Taxpayer's activities as betting commissioner and his operation of the card room were his only income-producing activities during the years in question, other than a small amount of income derived from investments in securities with his brother Herbert. In his personal gambling activity at the Film Row Club, his losses exceeded his gains. The gains and losses from his limited activities as bookmaker about balanced each other. (R. 208-209.)

The taxpayer's primary function as betting commissioner was to obtain opposite parties to a wager, receiv-

ing for his services a "commission" or fixed percentage of the amount involved in the wager. Ordinarily, Lesly would quote prevailing odds on horse races and other athletic events and if a customer wished to make a wager, taxpayer would attempt to locate others to accept or "cover the bet" in the same amount. Normally, taxpayer did not accept a wager as "placed" until he had found some other individual to "lay off" the other side of the same event. When taxpayer was able to "lay off" the entire amount of the bet, his profit or loss would not depend upon the outcome of the event, but would be a fixed percentage or "commission" of the total wager, which he retained on each bet. When able to do so, taxpayer would lay off the bet with one or more of his own local customers. When this could not be accomplished, he would lay off or cover the bet with other betting commissioners in the San Francisco Bay area and in other cities. He would not bring the customers betting on opposite sides of the same transaction into personal contact so that they could bet with each other. When Lesly located a client willing to accept the other side of a bet, he would confirm acceptance of the wager by telephone. Lesly was personally responsible for the collection of all betting commitments which he made, and had to pay the winner even if he was unable to collect from the loser. The taxpayer watched his credits closely. (R. 209-210.)

The commission to taxpayer on bets handled for his own customers was 5% on each bet handled by him, except that on horse racing bets only the loser paid a commission. These commissions were not split. On bets laid off with other betting commissioners, the commission was usually split, one-half going to taxpayer. At times, he found it necessary to waive his entire

commission in order to get the bet laid off with another betting commissioner. (R. 210.)

Occasionally, through miscalculations on taxpayer's part or other unforeseen circumstances, he accepted a bet and could not arrange to lay it off. He then found it necessary to carry the other part of the bet. On these occasions, he acted as bookmaker to the extent that he himself carried the bet. Except for such occasional instances, he did not carry any part of the bet himself. (R. 210-211.)

The taxpayer's betting commissioner enterprise was operated almost entirely on a credit basis. Comparatively insubstantial amounts of money were actually posted with taxpayer prior to the happening of the event which determined the wager. Normally taxpayer collected cash from local bettors and paid local winners in cash. Cash settlements were made with local customers following the happening of the sporting event. Settlements with other commissioners in the San Francisco area were likewise mainly in cash. Transactions with out-of-town betting commissioners were generally settled at periodic intervals by check. The periods varied and included settlements on a daily, weekly or monthly basis, or when the account reached a certain fixed sum in favor of taxpayer or the out-of-town broker. Such settlements were in effect the balancing of accounts between taxpayer and out-of-town betting commissioners. They usually represented the net amount due from a number of bets rather than a single bet. When it was necessary for taxpayer to remit to an out-of-town broker to settle an account, taxpayer usually sent his own personal check. Occasionally he was required to send cashier's checks. The taxpayer was unable to estimate what proportion of his betting com-

missioner transactions were with out-of-town brokers. The handling of bets of local customers as betting commissioner on a commission basis was a substantial part of taxpayer's business. (R. 211-212.)

The taxpayer maintained a "revolving fund" of about $3,000 in cash, which he used in making pay-outs to local winners. Checks, most of which were received from out-of-town brokers, were either deposited in taxpayer's commercial bank account or were endorsed and transferred, or cashed by taxpayer. The only cash deposits in taxpayer's commercial bank account during the years in question were, in the aggregate: $430 during 1948, $8,470 during 1949, and $13,955 during 1950. The taxpayer received cash from local bettors far in excess of the foregoing amounts in each of those respective years. His records of cash transactions as betting commissioner were kept only a few days until settlement was made. He never furnished to his accountant any records of his cash transactions or cash commissions received as betting commissioner. In preparing data for taxpayer's income tax returns for the years in question, neither the accountant who assembled the data nor the accountant who prepared the returns from such data took into consideration any undeposited cash. (R. 212.)

Throughout the years 1948, 1949 and 1950, taxpayer maintained a commercial bank account in the name of "Les Cohen" at the Market-Ellis Branch of the Anglo-California National Bank, San Francisco, California, where he deposited funds relating primarily to his activities as betting commissioner. The total deposits to taxpayer's commercial account in that bank for each of the years involved herein were in the following amounts: $508,384.23 for 1948, $404,118.69 for 1949, and

$283,129.80 for 1950. (R. 212-213.) Those deposits largely represented the taxpayer's receipts from other betting commissioners in settlement of accounts. (R. 213.)

The foregoing deposits consisted almost entirely of checks. During the entire three-year period in question the total amount of cash included in such deposits (detailed, *supra*, by years) was less than $25,000. Deposits totaling $2,905 were made to the bank account on January 3, 1951. (R. 213.)

During each of the years in controversy, taxpayer received a large number of checks payable to "Les Cohen" which were endorsed by him but not deposited. The total amounts thereof and the respective years in which received were $120,974.75 for 1948, $107,712 for 1949, and $22,613.75 for 1950. These undeposited checks likewise largely represented settlement of accounts. (R. 213.)

The taxpayer made payments by check in the settlement of accounts with out-of-town bettors totaling $292,283.46 in the year 1950.[3] (R. 213.)

During the taxable years in question, the taxpayer did not maintain any permanent or detailed records or formal books reflecting gross commissions or gross receipts and disbursements from his betting commissioner activities. Taxpayer was apprehensive that the possession of such records would be both incriminating to him and embarrassing to his customers if they fell into the hands of the law enforcement officers. For his own reference purposes, however, he kept a daily

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[3] The taxpayer, in his proposed Finding No. 50, and the Commissioner, in his proposed Finding No. 83, took the position, in effect, that payments in unspecified amounts were made under similar circumstances in 1948 and 1949. (R. 213.)

"master sheet" at the Kingston Club setting forth the transactions which he handled as betting commissioner. On a busy day, approximately 100 wagers were recorded thereon. After a day or two, when the master sheets had served their immediate purpose, they were destroyed to avoid possible seizure and use as evidence by police authorities. The effect of such destruction was likewise to render it impossible to make an accurate determination of the amount of his commissions received as betting commissioner. No record of such commissions was maintained by taxpayer. (R. 214.)

The taxpayer retained George T. Murton (formerly the accountant for the Kingston Club during the years Coplin operated the club) to maintain its records, and Murton, or Evje, an accoutant in Murton's firm, performed such service for the taxpayer during the years in question. (R. 214.)

Murton's procedure was to go to the Kingston Club at least once a month and take off the record of income and disbursements from the card room. He also collected memorandum sheets upon which the taxpayer had noted daily cash expenditures. Receipts or paid bills were usually attached. Murton took the bank statements and canceled checks and reconciled the bank statements with the check book stubs. The books of account of the card room were either used at the card room by Murton or taken to his office and returned to the card room where they were kept. The bank statements, canceled checks and memoranda of cash expenditures were kept by Murton either at his home or in his office. Murton compiled the results of his accounting work in a so-called ledger which was actually a compilation on columnar work sheets. (R. 214-215.)

Murton's method of arriving at taxpayer's gross income at the end of each year was as follows: He subtracted the amount in the bank at the beginning of the year from the amount in the bank at the end of the year. He then added to the net increase or decrease in the bank balance all of the expenses of the business and all of the withdrawals made by or for the taxpayer. The result was considered taxpayer's gross income from the Kingston Club. (R. 215.)

The accountants disregarded cash receipts (other than those deposited and reflected in the bank balance) and also disregarded cash payouts except those payouts substantiated by a memoradum from taxpayer. This was done on the theory that the $3,000 revolving fund remained approximately the same throughout the period. From the gross income thus arrived at Murton would deduct the taxpayer's deductible expenses. (R. 215-216.)

Petitioner did not inform Murton that he received a substantial amount of checks in each of the years in question in connection with his business as betting commissioner which he endorsed but did not deposit. (R. 216.)

For about five months in 1950, while Murton was ill, accountant Evje acted in his place and followed the same methods. Evje never saw any books recording cash receipts or betting records relating to taxpayer's activities as betting commissioner. Murton died some time in 1951. (R. 216.)

All business expenses listed on Murton's summaries and claimed as deductions on taxpayer's returns were allowed by the Commissioner. (R. 216).

Annual summary sheets were prepared by Murton and furnished to taxpayer and mailed to Calegari, a

certified public accountant who prepared the taxpayer's income tax returns. The summary sheets for the three years here involved were furnished by Murton to accountant Calegari and were used by the latter in the preparation of the taxpayer's income tax returns. Calegari did not keep any books or records for the Kingston Club operations or for any of taxpayer's betting commissioner activities. The only records maintained by Calegari relating to taxpayer's financial affairs were a set of books for Lesly's investment in various stocks and bonds, which he held as a joint venturer or partner with his brother Herbert. (R. 216-217.)

In the preparation of taxpayer's income tax returns for the years in question, Calegari was not given access to any books or records that may have been maintained with respect to the Kingston Club or for any of taxpayer's betting activities. In preparing taxpayer's income tax returns, Calegari relied on the annual summary sheets and profit and loss statements of the Kingston Club operations, which were sent to him by Murton. (R. 217.)

About the end of 1950, taxpayer's Federal income tax returns for the years 1948 and 1949 were audited by Internal Revenue Agent Parenti. The bank statements, cancelled checks and memoranda of cash expenditures referred to above, used in the preparation of the summary sheets for 1948 and 1949 by Murton, had been kept by the latter either at his home or in his office, and were made available to Revenue Agent Parenti. (R. 217.)

Revenue Agent Parenti based his examination of taxpayer's returns for 1948 and 1949 entirely on information and data furnished by accountant Evje of

Murton's office. After Agent Parenti audited taxpayer's returns for the years 1948 and 1949, he prepared and filed a report indicating deficiencies of $5,505.67 for 1948 and $4,689.23 for 1949. (R. 217.)

At the time of the trial in the instant case, the bank statements and cancelled checks for the years 1948 and 1949 could not be found. The taxpayer was able to produce only his cancelled checks for the last 11 months of 1950 and bank statements for the year 1950. (R. 217-218.)

In 1952, Internal Revenue Agent Glenn Adrian conducted an original examination of taxpayer's income tax return for 1950 and a re-examination of his 1948 and 1949 returns. At this time there was a nationwide investigation of betting commissioners and others engaged in gambling activities. As a result of this drive, Revenue Agent Adrian had acquired, at the time of his investigation, photostat copies of checks paid to or endorsed by "Les Cohen", which had been received from other revenue agents' offices throughout the United States. Many of those checks had been endorsed and cashed by taxpayer and had not been deposited in his commercial bank account. This information had not been available at the time of Revenue Agent Parenti's examination in 1950. (R. 218.)

Revenue Agent Adrian obtained authorization from the Commissioner of Internal Revenue for a re-examination of taxpayer's returns for 1948 and 1949, and a copy of the letter of authorization was furnished to taxpayer. At the beginning of his examination, Agent Adrian contacted accountant Calegari and was advised by him that taxpayer's attorney had all of taxpayer's existing books and records. Later, an agent of the Intelligence Division of the Internal Revenue Service

communicated with taxpayer's attorney and was informed that the attorney had all of the taxpayer's books in his office. In May, 1952, Revenue Agent Adrian caused a registered letter to be sent to taxpayer requesting that he produce his records, and a follow-up letter was sent to taxpayer in September of 1952. The taxpayer neither answered the letters nor produced his books and records. Thereafter, Agent Adrian contacted taxpayer's attorney who informed the agent that he would look at the records in his possession and would let Adrian know whether he could see them. Later the attorney informed Agent Adrian that he had looked at the records and that he would not show Adrian anything. (R. 218-219.)

Revenue Agent Adrian proceeded to make his audit on the basis of third-party records to the extent that they were available. The available records were (1) bank deposit tags which showed dates and amounts of deposits and a number identifying the banks on which the deposited checks were drawn, but no names identifying the makers of the checks; (2) copies of bank statements of taxpayer's accounts showing total deposits, and amounts and dates of payment of checks drawn on the account, but without names or other identification of payees; (3) photostat copies of checks payable to Les Cohen obtained from other internal revenue agents' offices; and (4) a transcript of an account on the books of the Film Row Club showing taxpayer's wins and losses from personal bets at that club. (R. 219.)

The taxpayer's wins and losses from gambling at the Film Row Club were as follows (R. 219):

Year	Amount Won	Amount Lost
1948	$61,695.00	$79,075.00
1949	63,500.00	69,912.50

The Commissioner computed taxpayer's taxable income for the years in question by the so-called bank deposit method. He determined that all monies deposited in the commercial bank, all checks received and endorsed but not so deposited (to the extent he had knowledge of them at the time the statutory notice was mailed), and all wins from the Film Row Club constituted income. Because of lack of substantiation, no deductions were allowed for pay outs or losses. None of the deductions claimed on taxpayer's returns were disallowed. (R. 220.)

Revenue Agent Adrian did not attempt to compute taxpayer's net income by the so-called net-worth method because taxpayer dealt in large sums of cash and the agent did not feel that he could accurately determine net worth for that reason and also because, having been refused taxpayer's books, he would not know how taxpayer made his investments. (R. 220.)

In taxpayer's tax returns for 1948 through 1950, on Schedule C, page 2 (profit or loss from business), the nature of the business was stated to be "brokerage". (R. 220.)

Gross profits (listed as total receipts) from the Kingston Club operations were reported on taxpayer's tax returns for the years 1948 and 1949 in the amounts of $56,795.13 and $66,274.91, respectively. On taxpayer's original income tax return for the year 1950, he reported gross profit (listed as total receipts) from Kingston Club in the amount of $1,836.28, and a net loss of $26,687.91. On July 28, 1954, taxpayer filed an amended return for the year 1950 on which he reported gross income (listed as total receipts) from Kingston Club of $8,207.71 and a net loss of $15,125.75. (R. 220-221.)

During the years involved herein the taxpayer had a safe deposit box at the Bank of America, Day and Night Branch. (R. 221.)

During each of the taxable years in question, the taxpayer received substantial commissions in cash from local customers. His settlements with local betting commissioners were almost entirely in cash, and reflected his share of commissions. (R. 221.)

The taxpayer's gross income from his activities as betting commissioner and the operation of the Kingston Club card room for the respective years in question did not exceed the following: $167,000 for 1948, $145,000 for 1949, and $108,000 for 1950. (R. 221.)

The taxpayer, in his income tax returns for each of the years in question, substantially understated income from his activities as betting commissioner and the operation of the Kingston Club card room. (R. 221.)

A part of the deficiency for each of the three years involved was due to fraud on the part of taxpayer with intent to evade taxes, within the meaning of Section 293(b) of the Internal Revenue Code of 1939. (R. 221.)

Upon the basis of the foregoing facts, the Tax Court, sustaining the Commissioner's determinations in part (R. 221-248), held that (1) the Commissioner, in the absence of any available books or records kept and/or made available by the taxpayer clearly reflecting his true income for the taxable years involved as required by law, correctly computed the taxpayer's taxable income and the resulting deficiencies in income taxes—to the extent redetermined by it—by the use of the bank-deposit method for those years (R. 221-228), (2) the Commissioner properly determined that the taxpayer had grossly understated his taxable income and the amounts of such understatements on his tax returns—to

the extent redetermined by the Tax Court—for each of the three taxable years involved (R. 228-243), and (3) part of the deficiencies in income taxes as determined and asserted against the taxpayer by the Commissioner was—to the extent redetermined by it—due to fraud with intent to evade the payment of income taxes for each of the taxable years 1948-1950 (R. 243-248). 1957 P-H Tax Court Memorandum Decisions, par. 57.172, decided September 12, 1957. The Tax Court thereupon entered its decision accordingly on December 12, 1957 (R. 249), from which the taxpayer petitioned this Court for review on March 4, 1958 (R. 250-256).

SUMMARY OF ARGUMENT

1. The taxpayer's corrected net income was properly ascertained and determined by the Commissioner—to the extent redetermined by the Tax Court—by the use of the bank deposit method. The evidence revealed the source of the taxpayer's understated, unreported income as having come from his extensive, lucrative gambling-business operations during the three taxable years involved when he made very substantial amounts of deposits in his checking account during each year, received certain undeposited checks which he cashed or endorsed and transferred to others without their being deposited in his bank account, and also from large winnings from gambling in the Film Row Club during each of the taxable years 1948 and 1949. The taxpayer was given every opportunity to explain the large understatements of income uncovered by the Commissioner's revenue agents but he declined to do so by honest reliable testimony, even to the extent of refraining from introducing his records (in his attorney's possession) in evidence. The Tax Court,

notwithstanding, made generous allowances in his behalf and otherwise redetermined his taxable income under the best-estimate approximation rule as authorized by the decisions of this Court and other Courts of Appeals. Since the taxpayer could not—or would not—explain the remaining discrepancies between his reported income and his unreported income as reconstructed by the bank deposit method, the Tax Court was not required to accept his unsupported statements, indeed found it necessary to reject his testimony as being, in the light of the record, wholly unconvincing and untrue. Hence, on the evidence before it, the Tax Court had no alternative than to find that the unexplained discrepancies represented understated, unreported taxable income for the three taxable years involved.

2. As to fraud, the Commissioner determined and established and the Tax Court found fraud accordingly for the taxable years 1948-1950 based on the following grounds: (a) the taxpayer's failure to keep any books or records clearly reflecting taxable income for those years, though required by law to do so, (b) his refusal to turn over such records as he did have to the Commissioner's revenue agents before and while investigating his income tax returns for the taxable years involved, as well as his refraining from introducing them in evidence at the hearing in the Tax Court, (c) his testimony which the Tax Court found necessary to reject as not being honest, correct and/or complete because an analysis of the record demonstrated the contrary, and (d) his failure to have reported taxable income aggregating $288,722.25 over the period of the three consecutive years involved, an annual average of understated income of more than $96,000, his tax-

able income ($288,722.25) for the three-year period having been more than eight times the total amount ($35,436.49) reported by him for those years. These items, together with other facts of record, constitute ample evidence to support the Tax Court's findings of fraud on the part of the taxpayer with intent to evade the payment of income taxes for all three years involved. The Tax Court found that the Commissioner met his burden of establishing fraud, nor did the taxpayer produce anything to disprove it.

ARGUMENT

I

The Record Amply Sustains the Tax Court's Redetermination of the Deficiencies for the Three Taxable Years Involved

The question presented here is whether the Tax Court properly held that the Commissioner, in the absence of any available and/or adequate books or records kept by the taxpayer clearly showing income for the taxable years 1948-1950 as required by law, correctly determined the taxpayer's taxable net income and the resulting deficiencies in income taxes—to the extent redetermined by it—by the use of the so-called bank deposit method for those years, under the pertinent provisions of the taxing statute. The taxpayer contends that the Tax Court erred in thus sustaining the Commissioner's determination to the extent redetermined by it (Br. 26-53), and we submit that his contentions are without merit.

A. *The Tax Court did not err in sustaining the Commissioner's determination of the taxpayer's unreported taxable net income and the resulting deficiencies—to the extent redetermined by it—for the three taxable years involved by the use of the bank deposit method*

If the taxpayer does not keep adequate books and records which "clearly reflect the income" for the taxable years involved as required by law, as the Tax Court found here (R. 214), the taxing act authorizes the Commissioner to compute his income by whatever method "in the opinion of the Commissioner does clearly reflect the income". Sections 22(a) and 41 of the Internal Revenue Code of 1939; Sections 29.22(a)-1, 29.41-1 and 29.41-3 of Treasury Regulations 111, all Appendix, *infra*. Moreover, the taxpayer is not only required to keep such permanent books of account or records clearly reflecting income but also to maintain them "at all times available for inspection" by the Commissioner's revenue agents and to retain them "so long as the contents thereof may become material in the administration of any internal-revenue law". Section 54(a) of the 1939 Code; Section 29.54-1 of Treasury Regulations 111, both Appendix, *infra*. The record here shows that taxpayer during the three taxable years involved concededly carried on extensive, lucrative business operations—much of which was handled by cash transactions—as a betting commissioner, made very substantial amounts of deposits in his checking account during each year, received certain undeposited checks which he cashed or endorsed and transferred to others during each year, and realized large winnings from gambilng in the Film Row Club during each of the years 1948 and 1949. Yet

the taxpayer neither kept adequate records showing the income realized from such gambling-business operations nor did he make such records as he did keep (though wholly inadequate) available for inspection and examination by the Commissioner's revenue agent who investigated his tax returns for the three taxable years involved. (R. 214, 218-219, 221-222, 227, 230.)

In these circumstances, it is clear that the Commissioner was fully justified in resorting to the taxpayer's bank deposits and other third-party sources in order to reconstruct and compute his understated, unreported taxable income, to the fullest extent possible under the circumstances, for each of the three taxable years involved. *Holland* v. *United States,* 348 U.S. 121, 130-132, rehearing denied, 348 U.S. 932; *Sterns* v. *Commissioner,* 235 F. 2d 584 (C.A. 9th); *Gobins* v. *Commissioner,* 217 F. 2d 952 (C.A. 9th), affirming *per curiam* 18 T.C. 1159; *Rose* v. *Commissioner,* 188 F. 2d 355 (C.A. 9th), certiorari denied, 342 U.S. 850, rehearing denied, 342 U.S. 889; *Roberts* v. *Commissioner,* 176 F. 2d 221, 226 (C.A. 9th); *Doll* v. *Glenn,* 231 F. 2d 186, 188 (C.A. 6th); *Thomas* v. *Commissioner,* 223 F. 2d 83, 86 (C.A. 6th); *Bodoglau* v. *Commissioner,* 230 F. 2d 336 (C.A. 7th); *Cohen* v. *Commissioner,* 176 F. 2d 394 (C.A. 10th); *Goldberg* v. *Commissioner,* 239 F. 2d 316 (C.A. 5th). Nor is the Commissioner's use of the bank deposit method in determining the existence of unreported income limited to situations where the taxpayer has or makes available no adequate books or records, as here, for the Government is at liberty to use any and all legal evidence available to it in determining whether the story told by the taxpayer's books and records accurately reflects his financial history and taxable income. *Holland* v.

United States, supra. There the Supreme Court stated in this connection (p. 132):

> Certainly Congress never intended to make Section 41 a set of blinders which prevents the Government from looking beyond the self-serving declarations in a taxpayer's books. "The United States has relied for the collection of its income tax largely upon the taxpayer's own disclosures * * * This system can function successfully only if those within and near taxable income keep and render true accounts." *Spies* v. *United States,* 317 U.S., at 495. To protect the revenue from those who do not "render true accounts," the Government must be free to use all legal evidence available to it in determining whether the story told by the taxpayer's books accurately reflects his financial history.

It has long been settled by this Court and by the other Courts of Appeals that, under circumstances such as those here involved, the Commissioner, having no alternative, is at liberty to determine taxable income from third-party records and other sources in order to establish, as accurately as possible, the true income, and therefore is warranted in treating as taxable income any unexplained excess of bank deposits over nontaxable and reported income. Section 41 of the 1939 Code; Section 29.41-1 of Treasury Regulations 111; *Gobins* v. *Commissioner, supra; Sterns* v. *Commissioner, supra; Rose* v. *Commissioner, supra; Roberts* v. *Commissioner, supra; Halle* v. *Commissioner,* 7 T.C. 245, affirmed, 175 F. 2d 500 (C.A. 2d), certiorari denied, 338 U.S. 949; *Hague Estate* v. *Commissioner,* 132 F. 2d 775 (C.A. 2d), certiorari de-

nied, 318 U.S. 787; *Goe* v. *Commissioner,* 198 F. 2d 851 (C.A. 3d), certiorari denied, 344 U.S. 897; *Mauch* v. *Commissioner,* 113 F. 2d 555 (C.A. 3d); *Stoumen* v. *Commissioner,* 208 F. 2d 903 (C.A. 3d); *Greenfeld* v. *Commissioner,* 165 F. 2d 318 (C.A. 4th); *Boyett* v. *Commissioner,* 204 F. 2d 205, 208 (C.A. 5th); *Miller* v. *Commissioner,* 237 F. 2d 830 (C.A. 5th); *Doll* v. *Glenn,* 231 F. 2d 186, 188 (C.A. 6th); *Hoefle* v. *Commissioner,* 114 F. 2d 713 (C.A. 6th); *Traum* v. *Commissioner,* 237 F. 2d 277 (C.A. 7th); *Marcella* v. *Commissioner,* 222 F. 2d 878 (C.A. 8th); *Cohen* v. *Commissioner,* 176 F. 2d 394 (C.A. 10th); *Moriarty* v. *Commissioner,* 18 T.C. 327, affirmed, 208 F. 2d 43 (C.A. D.C.); *Jacobs* v. *United States,* 126 F. Supp. 154, 157 (C. Cls.[4]). In *Boyett* v. *Commissioner, supra,* the Fifth Circuit said (p. 208), "Where, as here, the records kept by the taxpayer are manifestly inaccurate and incomplete, the Commissioner may look to other sources of information to establish income". To the same effect, see *Greenfeld* v. *Commissioner, supra.*

It is equally well settled by the foregoing cases that the Commissioner's determination of the corrected net

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[4] Substantially to the same effect are the decisions authorizing the Commissioner's computation and determination of taxable income, in the absence of books and records clearly showing income, by the so-called net worth method. *United States* v. *Johnson,* 319 U.S. 503, rehearing denied, 320 U.S. 808; *Holland* v. *United States, supra; Friedberg* v. *United States,* 348 U.S. 142, rehearing denied, 348 U.S. 932; *Smith* v. *United States,* 348 U.S. 147; *United States* v. *Calderon,* 348 U.S. 160. The Commissioner's Revenue Agent Adrian investigating the taxpayer's returns in the instant case, however, did not attempt to compute his taxable income by the net worth method because the taxpayer dealt in large sums of cash and Agent Adrian did not feel that he could accurately determine the net worth by that method for that reason and also because, having been refused access to the taxpayer's books and records, he would not know how the taxpayer made his investments (R. 196), as the Tax Court found (R. 220).

income was presumptively correct and the burden was on the taxpayer to show that it was wrong, that the Tax Court was not obligated to accept the taxpayer's uncorroborated testimony regarding his receipts and expenditures, and that the Tax Court's finding that the taxpayer grossly understated his taxable income may not be disturbed upon appeal unless clearly erroneous. See also, *United States* v. *Gypsum Co.,* 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869; *Quock Ting* v. *United States,* 140 U.S. 417.

Accordingly, it is clear that the Tax Court did not err in sustaining the Commissioner's determination of the taxpayer's understated, unreported income by the bank deposit method—to the extent redetermined by it—and in holding that such determination was neither arbitrary nor invalid. (R. 221-228.)

B. *The amounts of the taxpayer's understatements of unreported income and the resulting deficiencies were properly computed by the Commissioner—to the extent redetermined by the Tax Court—for each of the three taxable years involved*

In harmony with the consistent rule laid down by this Court and the other appellate courts in the series of analogous cases above mentioned, the Commissioner's Revenue Agent Adrian in early 1952 began his investigation of the taxpayer's income tax returns for the three taxable years 1948-1950 in order to ascertain and reconstruct his true income by the bank deposit method. (R. 190 *et seq.,* 220.) In the absence of any books or records clearly showing income kept by the taxpayer (R. 212, 214-215) and because of the refusal of the taxpayer's attorney to show him any of the taxpayer's records which he had in his possession (R. 173-174, 175,

177, 188-189, 196, 197, 204-205, 219, 227), as pointed out, Revenue Agent Adrian made his computations of the taxpayer's income on the basis of third-party records and other sources to the extent available (R. 219). These constituted (1) bank deposit tags showing dates and amounts of the taxpayer's deposits aggregating $1,195,632.72 for the years 1948-1950 (R. 190-194, 212-213, 219, 258-259), (2) copies of bank statements of the taxpayer's accounts showing total deposits and the amounts and dates of payments of checks drawn thereon but without names or other identification of the payees (R. 190 *et seq.,* 212-213), (3) copies of checks payable to the taxpayer (obtained from other offices of the Internal Revenue Service) in the aggregate sum of $251,300.50 for the three taxable years involved (R. 191-194, 213, 259-262), and (4) a transcript of the account on the Film Row Club's books showing the taxpayer's winnings ($125,195) and losses ($148,987.50) from his personal bets at that Club (R. 194-195, 196-197, 209, 219, 229). In so doing, Revenue Agent Adrian determined that all monies deposited by the taxpayer in his commercial bank account (R. 212-213), all checks received and endorsed but not so deposited by the taxpayer, and all winnings from the Film Row Club, constituted income (R. 190 *et seq.*[5]) as the Tax Court found (R. 220, 229).

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[5] Revenue Agent Adrian, in his computations, did not disallow any of the deductions claimed by the taxpayer on his tax returns for the taxable years involved nor, for lack of substantiation, did he allow any of the taxpayer's claimed deductions taken for pay-outs or gambling losses from the Film Row Club. (R. 195, 196-197, 201, 204-205, 220.) The Tax Court, however, while not directly allowing any of the taxpayer's pay-outs as offsets against deposits for any of the taxable years involved, for lack of substantiation (R. 225-226, 230), did make such allowances by indirection

Pursuant to the foregoing, Revenue Agent Adrian, in the absence of books or records kept by the taxpayer and without the benefit of the records the taxpayer did have, such as they were—which his attorney refused to turn over to him for use in the investigation—and finding the net worth method inadequate under the circumstances of this case, reconstructed and computed the taxpayer's net income from his various gambling operations for the taxable years as best he could by the use of the bank deposit method, as pointed out, thereby arriving at the total net amounts of $717,889.68, $578,-219.42 and $301,249.86, aggregating $1,597,358.96, for those years, respectively. These were the amounts determined and asserted against the taxpayer by the Commissioner in his statutory notice of deficiencies for the taxable years involved. (R. 7-12, 197, 202.) The record shows that in arriving at these figures, Revenue Agent Adrian, without access to the taxpayer's books and records, as pointed out, did the following—to large extent as shown by the stipulated facts (R. 257-262)—in ascertaining the taxpayer's taxable income for the three taxable years in question: Agent Adrian first made schedules from the bank's records of the tax-

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(R. 235, 236, 237). It also allowed the taxpayer's gambling losses to the extent of his gains for the years 1948 and 1949—this issue not being involved for the year 1950 (R. 229)—but correctly sustained the Commissioner's disallowance of any deductions for the excess of losses over wins for those years (R. 229). The statute provides that "Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions." Section 23(h) of the Internal Revenue Code of 1939; Section 29.23(h)-1 of Treasury Regulations 111. In any event, the taxpayer concedes that the Tax Court's "refusal to allow the excess of losses over wins was correct", adding, "Incidentally, Petitioner never contended before the Tax Court that the excess of losses [over wins] should have been allowed as a deduction". (Br. 39.)

payer's commercial bank account showing all deposits and checks written against the account as made by him during the three years in question (R. 190-191, 202, 258-259; Ex. 5-E). He thereupon made a complete analysis of the taxpayer's deposit tags identifying all items making up the deposits in his account. Against this, he checked all the taxpayer's available checks (copies of which Agent Adrian had) to determine whether they had been deposited or undeposited, and then separated them into two different schedules showing the total of the checks deposited—to the extent located and available [6]—and the total of the checks which had been cashed or endorsed over to others but not deposited, respectively. (R. 191-193, 258-262; Exs. F-I, K-R.) With the information and data thus gathered, Agent Adrian combined the totals of his verified schedules of deposited and undeposited checks, as found by him during his investigation, with the totals of the additional deposited and undeposited checks (not before available to or considered by him) as stipulated to by the parties, respectively. (R. 261-262; Ex. R.) He thereby determined that the taxpayer had deposited checks in the total sum of $1,195,632.72, and also had received and cashed or endorsed to others but not deposited checks totaling $251,300.50, aggregating $1,446,933.22, for the three taxable years involved. (R. 194, 212-213.) To the total amount of deposited and undeposited checks thus ascertained, plus total cash

[6] Agent Adrian was able to locate approximately one-fifth of the checks deposited by the taxpayer during the taxable year 1948 and about one-half of those deposited during the years 1949 and 1950. (R. 192-193.) The remaining checks, as stipulated (R. 258-262), not theretofore available to Revenue Agent Adrian, were received in his office after he had completed his examination of the taxpayer's returns for the taxable years involved (R. 193, 203-204).

($22,895) deposited in the taxpayer's bank account during the taxable years involved (R. 194, 212), Agent Adrian added the taxpayer's "wins" (totaling $125,-195) from the Film Row Club for the taxable years 1948 and 1949 (R. 195, 196, 197, 219, 229), thus arriving at the grand total of $1,595,023.22 representing taxable income chargeable to the taxpayer for the three taxable years involved, "and that was the figure which was used in the computation of the tax in each of the [three taxable] years considered" by him (R. 194). This, together with the additional information and data received by the Commissioner after Agent Adrian's investigation and report thereof (R. 193, 203-204, 221-222), formed the basis of the Commissioner's deficiency notice sent to the taxpayer on November 25, 1952 (R. 7-12, 197, 202), as pointed out. In these computations, moreover, Agent Adrian, as in the case of the taxpayer's gambling losses, made no allowance for the taxpayer's "payouts", for lack of substantiation (R. 195, 201), nor, for the same reasons, did the Commissioner in his determination of deficiencies make any allowanes therefor (R. 8-12, 225-226 [7]).

In view of the foregoing, it cannot properly be said that the Commissioner's revenue agent, in the absence of any books or records kept and/or made available by the taxpayer, did anything other than what was necessary in order to compute the taxpayer's taxable income by the bank deposit method. The taxpayer, on the other hand, had reported on his income tax returns as filed for the taxable years involved net income of only

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[7] Neither did the Tax Court—except for gambling losses (R. 225, 229)—for the same reasons (R. 220, 225-226, 230, 235, 236-237), except to an undisclosed extent by indirection (R. 235, 236, 237). (See fn. 5, *supra*.)

$24,540.94 and $35,740.69 and a loss of $24,845.14, respectively, aggregating net income reported of $35,436.49—an average of only $11,812.16—for the three taxable years. (R. 9-11.) Accordingly, the Commissioner properly determined that the taxpayer, in thus reporting far less than his true income, had grossly understated his taxable net income for all years involved.

C. *The Tax Court properly redetermined the volume of the taxpayer's bets handled and the gross commissions received thereon on the basis of his bank deposits for each of the three taxable years involved*

The Tax Court, in the absence of any adequate books or records kept or made available by the taxpayer, used the taxpayer's bank deposits for the purpose of redetermining the volume of his out-of-town bets handled as betting commissioner and, in turn, his gross commissions received thereon for each of the three taxable years involved. (R. 229-243.[8]) In so doing, the

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[8] The record shows that the taxpayer's only "income-producing activities during the [taxable] years in question" were those carried on as betting commissioner and his operation of the Kingston Club card room (except for a small amount of income derived from investments in securities with his brother, not in dispute here), and that his gross commissions from such activities and net understatements thereof in his returns were determined by the Tax Court on the basis of his bank deposits. (R. 209, 221, 229-238.) In the absence of any showing of separate income or loss from the taxpayer's operations of the Kingston Club card room (R. 209), moreover, the Tax Court, in its redetermination of the taxpayer's gross income and understatements thereof with respect to his activities as betting commissioner, included therein "any income or loss from the Kingston Club card room" (R. 237-238). The taxpayer's other income (gains from his personal gambling activities at the Film Row Club) was exceeded by his losses sus-

Tax Court, on the basis of the taxpayer's total deposits of checks and money orders and checks received and cashed or endorsed to others, representing remittances from out-of-town betting commissioners with whom he had placed lay-off bets which he had been unable to place locally, and with whom he had credit balances in his favor, and also checks issued in *net* settlement of accounts (embracing wins, losses and commissions (R. 232)), determined a substantial portion of the taxpayer's gross commissions received on lay-off bets for each of the taxable years involved (R. 231-237). The record shows that the taxpayer's deposits, though "largely representative of the settlement of [his credit balances for] bets laid off" with out-of-town betting commissioners, did not represent all of the bets thus laid off with foreign commissioners for he also received other checks in substantial amounts in net settlement of accounts during each taxable year which, as pointed out, he either cashed or endorsed over to others but did not deposit, and on the basis of which the Tax Court redetermined the remaining portion of the taxpayer's gross commissions received during those years. (R. 232-233, 235-236, 237.) Likewise, the taxpayer issued substantial checks during each taxable year to out-of-town betting commissioners in net settlement of accounts having credit balances in their favor. (R. 233, 236, 237.[9]) In this connection, the Tax Court found (R. 233) that—

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tained therein (R. 209, 219, 229), and was determined by the Commissioner and the Tax Court from the transcript of the records of the Film Row Club as furnished the Commissioner's revenue agent by that Club (R. 195).

[9] The amounts of such net settlement checks issued by the taxpayer during the taxable years 1948-1949 are not in the record but they were determined by the Tax Court for those years on the

> The total of checks deposited, checks cashed or endorsed, and checks issued *represents a minimum of layoff bets,* because, as already indicated [R. 231-232], they represented [net] settlement of accounts arising out of more than one bet. The total of layoff bets, therefore, must have materially exceeded such total. [Italics supplied.]

Accordingly, on these bases, the Tax Court—in the absence of any adequate books or records kept and/or made available by the taxpayer, as pointed out, and because of the taxpayer's inability to estimate the proportions of his local bets to the out-of-town bets (R. 234), and reconciling and integrating the diverse and variegated elements involved—found, upon all the evidence, by means of painstaking estimate and approximation as best it could from the vague and meagre record before it, that the taxpayer received gross commissions from his activities as betting commissioner not in excess of $167,000, $145,000 and $108,000, aggregating $420,000, for the taxable years 1948-1950, respectively, and that the taxpayer had failed to establish any

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basis of the showing in the record that the total of such checks issued by him in net settlement of accounts with out-of-town bettors totaled $292,283.46 for the taxable year 1950. (R. 213.) The Tax Court concluded that since both of the parties in the Tax Court took the position, in effect, that such net settlement payments in unspecified amounts were also made under similar circumstances during the years 1948 and 1949, as in 1950, and they were satisfied that the same general pattern of such payments by check existed in 1948 and 1949—in each of which years deposits and undeposited checks exceeded those in 1950 (R. 240)—the amounts thereof for 1948 and 1949 were properly determinable on the basis of the 1950 payments of the same general pattern (R. 213, 233, 236, 237, 240).

lesser amounts for those years (R. 221, 234-237).[10] Hence, since the taxpayer had reported gross income from the operation of the Kingston Club in the sums of $56,795.13, $66,274.91 and $8,207.71 for those years, respectively, the Tax Court, subtracting the latter amounts from the gross commissions determined by it for each of those years, respectively, found the taxpayer's net understatements of taxable income in the total net sums of $110,204.87, $78,725.09 and $99,792.99 for the years 1948-1950, respectively. (R. 221, 235-237.[11] Moreover, while the Tax Court, like the Commissioner (R. 220), because of lack of substantiation and/or bases for calculating the amounts thereof, did not make any direct allowances or offsets for the taxpayer's pay-outs as such—though it surmised that the taxpayer as a betting commissioner "must have had substantial pay outs" (R. 230)—yet it did make allowances therefor in undisclosed amounts by indirection, notwithstanding the taxpayer's failure of proof, for each of the taxable years involved (R. 235, 236, 237). As the Tax Court put it in respect of the year

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[10] These amounts of gross income, after giving effect to additional allowances and deductions decreed by the Tax Court (R. 221-243), were revised and decreased by the Commissioner to the amounts of $134,904.93, $114,465.78 and $84,991.14 for the taxable years 1948-1950, respectively, as shown in the agreed computations for entry of decision under Tax Court Rule 50 as filed with the Tax Court on December 3, 1957 (R. 264).

[11] In this connection, the Tax Court stated (R. 237-238):

> The gross income and understatements determined by us with respect to petitioner's activities as betting commissioner for each of the years in question include any income or loss from the Kingston Club card room. [R. 209.] No separate income or loss from the [Kingston Club] card room operation has been reliably established.

See, also, fn. 8, *supra*.

1948 (R. 235), "To the extent that our approximation [of the taxpayer's gross commissions] approaches accuracy * * *, it necessarily gives indirect effect to the allowance of pay outs." (To the same effect, see also the Tax Court's similar statements in respect of the taxable years 1949 and 1950. (R. 236, 237.))

Under the foregoing circumstances, the Tax Court found upon the record as a whole as follows (R. 214, 226, 227, 235, 236, 237, 240-242, 243):

> We conclude with respect to 1948, that it is not likely that petitioner received gross commissions as betting commissioner in excess of $167,000 [R. 221], and that petitioner has failed to establish a lesser amount. From this, we subtract the gross income of $56,795.13 of the Kingston Club reported by petitioner in his income tax return [R. 220], and we find a net understatement of income as betting commissioner for 1948 in the amount of $110,204.87.
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> * * * * *
>
> From all of the foregoing, we have concluded that it is not likely that petitioner received gross commissions in 1949 in excess of $145,000 [R. 221] and that petitioner has failed to establish a lesser amount. Subtracting gross income of $66,274.91 of the Kingston Club reported by petitioner in his income tax return [R. 220], we find a net understatement of income as betting commissioner for 1949 in the amount of $78,725.09. What we have said concerning other income and expenses and also, with respect to indirect allowance of pay outs for 1948, applies to 1949 as well.
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> * * * * *

As to 1950, we have concluded that it is not likely that petitioner received gross commissions in excess of $108,000 [R. 221] and that petitioner has failed to establish a lesser amount. Subtracting therefrom gross income from business in the amount of $8,207.71 reported by petitioner in his amended income tax return for 1950 [R. 220-221], we find a net understatement of income as betting commissioner for 1950 in the amount of $99,792.29. What we have said with respect to other income and expenses, and indirect allowance of pay outs for 1948 and 1949 applies also to 1950.

* * * * *

Keeping the above factors in mind, we think the record supports the inference (after due consideration of the variations in commissions which we have aready discussed) that petitioner received commissions from local bets in amounts not less than the following: 1948, $69,000; 1949, $60,000; 1950, $44,000.* * *

His [taxpayer's] method of doing business necessarily resulted in an excess of total receipts over total pay outs, and the volume of his business, inferable from the record, and the rate of commissions (allowing for the variations which we have already recognized), were such that his total commissions for each year involved greatly exceeded those reported.* * *

Upon the basis of these facts, the Tax Court found as ultimate facts (R. 221) that——

Petitioner's gross income from his activities as betting commissioner and the operation of the

Kingston Club card room for the respective years in question did not exceed the following: 1948-$167,000; 1949-$145,000; 1950-$108,000 [aggregating $420,000]. Thus, in view of the foregoing, it is clear, we submit, that the Tax Court's redeterminations and findings of the taxpayer's understatements of income for the taxable years involved have full support in the record.

Under the decisions, the foregoing findings of the Tax Court are entitled to finality where, as here, they are supported by substantial evidence and certainly are not shown by the taxpayer to be clearly erroneous. Rule 52(a) of the Federal Rules of Civil Procedure; *United States* v. *Gypsum Co.,* 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869; *Joe Balestrieri & Co.* v. *Commissioner,* 177 F. 2d 867, 873 (C.A. 9th); *Grace Bros.* v. *Commissioner,* 173 F. 2d 170, 173-174 (C.A. 9th). "Here, the decision below was consistent with findings which on the evidence were well within the province of the trier" of the facts. *Chesbro* v. *Commissioner,* 225 F. 2d 674 (C.A. 2d), certiorari denied, 350 U.S. 995. Surely the Tax Court was not obliged to believe the taxpayer's self-serving testimony, whether or not contradicted or controverted, where it was patently untrue, incorrect and unconvincing, as here. (R. 238, 241-242, 246-247.) [12] *Quock Ting* v. *United States,* 140 U.S. 417; *Carmack* v. *Commissioner,* 183 F. 2d 1, 2 (C.A. 5th), certiorari denied, 340 U.S. 875; *Burka* v. *Commissioner,* 179 F. 2d 483, 485 (C.A. 4th);

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[12] In this connection, the Tax Court stated (R. 246) that——

> In the light of the foregoing, we, of course, reject petitioner's testimony to the effect that his returns were honest, correct and complete because analysis of the record demonstrates to the contrary.

Cohen v. *Commissioner,* 176 F. 2d 394, 399 (C.A. 10th). Neither was the Tax Court bound to accept the taxpayer's testimony "when there are facts which even indirectly may give rise to inferences contradicting the witness," as here. *Cohen* v. *Commissioner,* 148 F. 2d 336, 337 (C.A. 2d).

From the foregoing, it will be noted that, contrary to the taxpayer's contentions (Br. 49-51), there is ample support in the record for the Tax Court's redeterminations and findings of the taxpayer's gross understatements of income for each of the taxable years involved. The taxpayer contends nevertheless, substantially as in the Tax Court (R. 225-226), that the Tax Court, fully cognizant of the nature of his business as a betting commissioner handling large sums of money annually which necessarily required pay outs, erred in treating his deposits as gross income without allowing any deductions or eliminations therefrom for pay outs (Br. 37-41).[13] As against this, the Tax Court held that the taxpayer, having maintained and/or made available no records from which pay outs could be calculated or offered anything in substantiation thereof, and therefore confronted with inability to meet his burden of proof—which certainly did not thereby shift to the Commissioner—he was merely left with an unenforceable claim, a hardship of his own making, citing *Burnet* v. *Houston,* 283 U.S. 223. (R. 225-226.) In this connection, the Supreme Court stated in the *Burnet-Houston* case (p. 228) that——

> The impossibility of proving a material fact upon which the right to relief depends, simply leaves

[13] We have already shown that the Tax Court, by indirection, made allowances for pay outs in undisclosed amounts for each of the taxable years involved. (R. 235, 236, 237.)

> the claimant upon whom the burden rests with an unenforcible claim, a misfortune to be borne by him, as it must be borne in other cases, as the result of a failure of proof.

See also *Interstate Transit Lines* v. *Commissioner,* 319 U.S. 590, 593; *Helvering* v. *Bruun,* 309 U.S. 461, 467-468; *Helvering* v. *Taylor,* 293 U.S. 507, 514-515; *Hague Estate* v. *Commissioner,* 132 F. 2d 775, 778 (C.A. 2d). Specifically in point, the Tax Court cited (R. 222-223) and relied on *Doll* v. *Glenn,* 231 F. 2d 186 (C.A. 6th) (1956) where the court, citing other analogous cases, said (p. 188):

> In the absence of the books and records of the Doll Lumber Company, the Commissioner was justified in treating the deposits in the bank account of H. A. Doll as gross income with the burden resting upon the taxpayer to show *what amounts, if any, were nontaxable income, and what deductions, if any, should be properly credited against it.** * * [Italics supplied.]

To the same effect, the Tax Court cited (R. 223) and relied on this Court's decisions in *Gobins* v. *Commissioner,* 217 F. 2d 952, affirming *per curiam* 18 T.C. 1159, 1168, and *Sterns* v. *Commissioner,* 235 F. 2d 584.

Nor did the Tax Court stop at this point but further showed not only that its findings of the taxpayer's understatements of income for the taxable years involved (R. 221, 229-238) are—contrary to the taxpayer's contentions here (Br. 48-51)—amply supported by the record, but also that he had received other income in cash which he did not report (R. 227, 238-243). As the Tax Court stated, while the Com-

missioner based his determination of the taxpayer's increases in his business income solely on deposits and undeposited checks cashed or endorsed over to others by him (plus the Film Row Club's gains, without offsetting losses), as already shown, yet it is clear from the record that the taxpayer had received substantial amounts in cash which he neither deposited nor reported and which the Commissioner did not include in his determination of the taxpayer's unreported business income. (R. 226-227, 238-243.) The Tax Court thereupon proceeded to demonstrate that—contrary to the taxpayer's contention (substantially as here (Br. 51-53)) that he, though engaged in an illegal business, was nevertheless an "honest" gambler and therefore his testimony that his tax returns as prepared by his Accountant Murton (and/or his assistants) should be accepted as filed, without a finding of any deficiencies (R. 238)—the taxpayer had, and was well aware of the fact that he had, realized substantial amounts of additional income from local cash bets in excess of his income reported, over and above that determined and included in his income by the Commissioner, for each of the taxable years in question (R. 238-243). In so doing, the Tax Court rejected the validity of the taxpayer's tax returns as prepared by his Accountant Murton because the latter's method of determining the income as reported thereon was faulty and erroneous. The reasons therefor were that Accountant Murton had completely disregarded and failed to take into consideration the taxpayer's undeposited cash in such returns on the theory that the "revolving fund" maintained by the taxpayer at approximately $3,000 was used by him in making pay outs to local winners, with any excess cash over and

above that amount purportedly deposited in the taxpayer's commercial bank account (R. 212), and therefore it was allegedly reflected in Accountant Murton's calculations in the tax returns as prepared by him and filed by the taxpayer (R. 212, 239). The record shows, however, that the taxpayer never furnished Accountant Murton any records of any of his cash transactions, cash bets placed, cash receipts, cash disbursements and/or cash commissions received as betting commissioner, and consequently Accountant Murton, in preparing the taxpayer's returns for the taxable years in question, never took into consideration any of the taxpayer's undeposited cash. (R. 212, 239.) The Tax Court found, moreover, that despite the fact that the taxpayer's local bets were largely settled in cash, only a small portion of such cash ever found its way into the taxpayer's commercial bank account as shown by the fact that out of total deposits of $1,195,632.72 therein, averaging $398,544.26 annually for the three taxable years involved (R. 212-213), cash only in the amounts of $430, $8,470 and $13,955, aggregating $22,895, had been deposited therein during those years, respectively (R. 212, 241).

In these circumstances, the Tax Court, stating that though there is no specific evidence in the record as to the amounts of local bets placed by the taxpayer, yet "a conservative estimate [thereof] may be inferred from correlation with the amount of bets laid off with out-of-town betting commissioners", and just as the evidence in respect of the out-of-town bets furnished the Tax Court a basis for an estimate or approximation of the total out-of-town bets (R. 231-237), as already shown, so, as a corollary, the same evidence furnished a basis for an estimate and approximation

of the taxpayer's local cash bets (R. 239-240 [14]). Accordingly, the Tax Court concluded upon all the evidence that the record supports the inference that the taxpayer received commissions from local cash bets in amounts not less than $69,000, $60,000 and $44,000, aggregating $173,000, for the three taxable years 1948-1950, respectively (R. 240-241), and thereupon found (R. 241) that—

> We think it apparent upon consideration of all of the circumstances that large amounts of cash commissions in each of the years in question were not deposited in the bank and could not have been reflected in [Accountant] Murton's figures which disregarded cash or in petitioner's income tax returns [as filed for those years] based on Murton's data.

Moreover, the Tax Court, rejecting the taxpayer's contention that all cash receipts (including cash commissions) were used for pay outs (R. 241), further found (R. 241-242) that——

> His [taxpayer's] method of doing business necessarily resulted in an excess of total receipts over total pay outs, and the volume of his business, inferable from the record, and the rate of commissions (allowing for the variations which we have already recognized) were such that his total commissions for each year involved greatly exceeded those reported. Since the total commissions were obviously not reflected in his commercial bank

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[14] In this connection, the Tax Court stated (R. 240) that——

> We think the foregoing furnishes a basis for an estimate or approximation of total out-of-town bets. As a corollary, it furnishes a basis for approximating local bets. * * *

account, the inference is clear that they were received and retained in cash. * * *

The foregoing, we submit, further tends to show that the record fully supports the Tax Court's redetermination of the taxpayer's understatements of income totaling $420,000 for the taxable years in question. (R. 221, 235-237.)

By virtue of the unusual circumstances of this case, the Tax Court, cognizant of the fact that the burden of proof was on the taxpayer to show the Commissioner's determination wrong and to establish *all* the elements upon which his right to deductions was based under the rule of *Helvering* v. *Taylor,* 293 U.S. 507, 515, and *Burnet* v. *Houston,* 283 U.S. 223 (R. 224-225), nevertheless realized the impossibility of accurate determination of the taxpayer's tax liability upon this record because of his failure to have kept essential records showing income. Hence, the Tax Court considered it its duty, not merely to sustain the Commissioner's determination harshly and unrealistically but, rather, to approach the problem indirectly by analysis of the record in the light of the best-estimate rule of *Cohan* v. *Commissioner,* 39 F. 2d 540 (C.A. 2d). In so doing, the Tax Court resolved any reasonable doubts against the taxpayer, and reconstructed his gross income at a figure which, in its judgment, his income would be unlikely to have exceeded *in fact*—the taxpayer having failed to establish any lesser amount. (R. 230.) In support of its action, the Tax Court relied on this Court's decision in *Roberts* v. *Commissioner,* 176 F. 2d 221, 226, from which it quoted and stated as follows (R. 231):

The petitioner had kept no books. So the Tax Court had to determine the amount from such evi-

dence as was presented to them. *If the result is an approximation, the lack of exactitude is traceable to the petitioner's own failure to keep accurate account.* As said by the Court of Appeals for the Second Circuit:

> "Absolute certainty in such matters is usually impossible and is not necessary; the Board should make as close an approximation as it can, bearing heavily if it chooses upon the taxpayer whose inexactitude is of his own making." *Cohan* v. *Commission,* 1930, 39 F. 2d 540, 543, 544. * * * [Emphasis supplied.]

In the instant case, we make no pretense at precision. We merely do our best to circumscribe the results within practical limits by the exercise of our judgment within the scope of the principles announced in *Roberts, supra,* and *Cohan, supra.*

It is clear that the Tax Court, in so doing, did *all* it possibly could in order to avoid being harsh and unrealistic under the meagre, inadequate facts of this case, nor did the taxpayer meet his requisite burden of showing that the Commissioner's determination, as redetermined by the Tax Court, was arbitrary and/or invalid. *Helvering* v. *Taylor, supra; Burnet* v. *Houston, supra; Viles* v. *Commissioner,* 233 F. 2d 376, 379 (C.A. 6th). In these circumstances, the Tax Court, in view of the taxpayer's disingenuous tactics resorted to in giving untrue and incredible testimony (see fn. 12, *supra*), would have been justified in applying a severe measure. The taxpayer cannot complain of the Tax Court's estimates and approximations when, as here, the findings are based on the best evidence available

and the taxpayer chose not to help.[15] *Roberts* v. *Commissioner,* 176 F. 2d 221, 226 (C.A. 9th), citing *Cohan* v. *Commissioner,* 39 F. 2d 540 (C.A. 2d). In this connection, the Tax Court cited (R. 227-228) *Greenwood* v. *Commissioner,* 134 F. 2d 915, where this Court stated as follows (pp. 919, 922):

> "Unquestionably the burden of proof is on the taxpayer to show that the Commissioner's determination is invalid." (*Helvering* v. *Taylor,* 1935, 293 U.S. 507, 515 * * *), which burden is sustained by a clear showing that the determination was arbitrary or erroneous. * * *
>
> * * * * *
>
> Petitioner has failed to overcome the presumption of validity attaching to the determination of the Commissioner, * * *

To the same effect, *American Pipe & Steel Corp.* v. *Commissioner,* 243 F. 2d 125, 126-127 (C.A. 9th), also cited by the Tax Court (R. 228); see also *Viles* v. *Commissioner,* 233 F. 2d 376, 379 (C.A. 6th), citing *Helvering* v. *Taylor,* 293 U.S. 507.

In view of the foregoing, we believe that a detailed discussion of the numerous items of income, etc., complained of variously by the taxpayer (Br. 32-53), which were given full consideration and effect by the Com-

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[15] As already pointed out, the taxpayer's counsel not only refused to give the Commissioner's revenue agent the benefit of the use of the taxpayer's records—which counsel concededly had in his possession (R. 218-219)—during his investigation of the taxpayer's income tax returns (R. 188-189, 196, 197, 204-205, 219, 227), but also the taxpayer's testimony was so incorrect and untrue that the Tax Court was obliged to reject as being incorrect and untrue (R. 246). See fn. 12, *supra.*

missioner in his determination (R. 7-12), and by the Tax Court in its findings and redetermination (R. 207-243), is unnecessary. It is sufficient to observe that the Tax Court's findings of fact dispose of the taxpayer's contentions as to the various disputed items; that such findings are all supported by substantial evidence, including the testimony of the taxpayer's own witnesses, and that the Tax Court's findings, so supported, are conclusive upon review. *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U.S. 37; *Phillips* v. *Commissioner,* 283 U.S. 589; *Burnet* v. *Leininger,* 285 U.S. 136. Even if it were true that the unreported income of the taxpayer was not determined with absolute precision, a fact which the Tax Court explained in full detail as warranted by the decisions of this Court and other Courts of Appeals (R. 230-231), the difficulty is apparently due in large part to the taxpayer's failure, indeed refusal, to have introduced his own records from which it could undoubtedly have been much more accurately determined. In such circumstances, approximation in the calculation of net income is justified. *Roberts* v. *Commissioner,* 176 F. 2d 221, 226 (C.A. 9th); *Cohan* v. *Commissioner,* 39 F. 2d 540, 543, 544 (C.A. 2d); *Harris* v. *Commissioner,* 174 F. 2d 70 (C.A. 4th); *Halle* v. *Commissioner* 175 F. 2d 500 (C.A. 2d), certiorari denied, 338 U.S. 949; compare *Helvering* v. *Safe Deposit Co.,* 316 U.S. 56, 66-67.

The taxpayer's fundamental objection to the results arrived at by the Tax Court is that the Tax Court allegedly erred in holding that he had failed to show that the Commissioner's determination of deficiencies was arbitrary and invalid, and that the burden was on the taxpayer to establish that he did not owe the amounts determined by the Commissioner in the deficiency

notice. (Br. 26-41.) For this contention, likewise advanced in the Tax Court (R. 224), the taxpayer relies heavily on *Helvering* v. *Taylor,* 293 U.S. 507 (Br. 27-28). We have already shown that this contention is wholly without merit as being without support in the record, nor does the taxpayer show anything to the contrary here leading to a different result. Moreover, the taxpayer's reliance on *Taylor* and similar cases (Br. 27-28) is manifestly misplaced. In the *Taylor* case the Government contended that even where the taxpayer has shown that the Commissioner's determination was arbitrary and excessive, he must prove the correct amount of the tax in order to succeed. The Supreme Court held to the contrary, for otherwise the Commissioner's determination would stand. We make no such contention here, nor did the Tax Court so hold. The taxpayer here has not shown that the Commissioner's determination—to the extent redetermined by the Tax Court—was arbitrary or that it was excessive. (R. 224-225.) The *Taylor* case holding that a case may be remanded to permit the taxpayer to introduce further evidence in nowise detracts from the familiar rule that the taxpayer is required "to show not only that the Commissioner is wrong but also to produce evidence from which a proper determination may be made." 9 Mertens, Law of Federal Income Taxation, p. 286. The taxpayer here was afforded full opportunity to meet the burden of proving the Commissioner's determination to be wrong, if it was, and to the extent that the taxpayer proved it to be wrong the Tax Court overruled the Commissioner—indeed, even more so by allowing the taxpayer's unproved losses to the extent of gains, for example (R. 229)—and reduced the asserted deficiencies accordingly. The taxpayer had every op-

portunity to prove his case and to remedy the deficiencies in his proof. The taxpayer, however, declined to take advantage thereof to prove his case, even to the extent of failing to introduce his own records in evidence. (R. 227.) See fn. 15, *supra*. In these circumstances, it is clear that, upon this record, the Commissioner's determination as redetermined by the Tax Court upon the record as a whole should be given effect.

Finally, we submit that the failure of the taxpayer to have furnished his records to the Commissioner's revenue agent during the investigation of his tax returns for the taxable years involved and/or to the Tax Court during the hearing of his case carries with it the clear implication that such documents, if offered, would have been detrimental to his case. Cf. *Interstate Circuit* v. *United States,* 306 U.S. 208, 226; *Cohen* v. *Commissioner,* 9 T.C. 1156, 1163-1164, affirmed, 176 F. 2d 394, 397, 399 (C.A. 10th); *Wichita Term. El. Co.* v. *Commissioner,* 6 T.C. 1158, 1165, affirmed, 162 F. 2d 513 (C.A. 10th). It is a settled rule in both civil and criminal cases that if a party has it within his power to produce evidence which would elucidate the matter in dispute, the fact that he refrains from doing so creates a presumption that the evidence, if produced, would have been unfavorable. *Interstate Circuit* v. *United States,* 306 U.S. 208, 226; *Mammoth Oil Co.* v. *United States,* 275 U.S. 13, 52; *Kirby* v. *Tallmadge,* 160 U.S. 379, 383; *Graves* v. *United States,* 150 U.S. 118, 121; *Cohen* v. *Commissioner,* 176 F. 2d 394, 399 (C.A. 10th). Moreover, if the taxpayer may deliberately fail to keep and make available books and records clearly showing his true income—though required by law to do so (Section 54(a) of the 1939 Code; Section 29.54-1 of Treasury Regulations 111, both Appendix, *infra*)—and to

withhold his records from the Commissioner's investigating revenue agents, the Tax Court and now this Court with immunity, lest he incriminate himself, as here (R. 173-175, 176-177, 188-190, 204-205, 226, 227, 246-247), he can thereby defeat the effectiveness of the income tax laws so far as he is concerned. The taxpayer has thus far succeeded in so doing here, and now, trapped by the fraud of his own making (dealt with under Point II, *infra*), he has the temerity to implore this Court for relief, taxwise, from his dilemma. Upon the basis of prior decisions of this Court—too numerous to warrant mentioning—we submit that such relief should be denied him forthwith.

II

The Tax Court Correctly Found upon the Entire Record that a Part of the Deficiencies in Taxes Was Due to Fraud with Intent to Evade Taxes for Each of the Three Taxable Years 1948-1950, and Therefore He Is Liable for the 50 Per Cent Fraud Penalties as Redetermined by the Tax Court for Those Years, Under the Pertinent Provisions of the Taxing Statutes

The question presented here is whether the record supports the Tax Court's findings made upon all the evidence, that the taxpayer is liable for the 50 per cent fraud penalties imposed by the taxing statute (Section 293(b) of the Internal Revenue Code of 1939, Appendix, infra) as statutory additions to his income taxes, as determined and asserted against him by the Commissioner—to the extent redetermined by the Tax Court—for the taxable years 1948-1950. The Tax Court found that the taxpayer was guilty of fraud for each of those years and therefore he is liable for the fraud penalties as asserted for such years. (R. 243-248.) The taxpayer contends that this is error. (Br. 53-62.)

Section 293(b) of the Internal Revenue Code of 1939 provides that "If any part of any deficiency is due to fraud with intent to evade tax," then 50 per cent of the deficiency shall be added thereto. It has been held that these plain words leave no room for construction. *Mauch* v. *Commissioner,* 113 F. 2d 555 (C.A. 3d). On this point, the Tax Court found, upon all the evidence, as ultimate facts that a part of the deficiency asserted for each of the three taxable years involved was due to fraud with intent to evade taxes within the meaning of Section 293(b) (R. 221), and thereupon sustained in large part the determination of the Commissioner —who had carried his burden of proof in this respect (Section 7454 of the 1954 Code, Appendix, *infra*) (R. 243-248).

It is settled that whether an understatement of or failure to report income is due to fraud presents solely a question of fact, and that the Tax Court's determination in respect thereto is final if supported by substantial evidence and is not shown to be clearly erroneous, as here. *Carmack* v. *Commissioner*, 183 F. 2d 1 (C.A. 5th), certiorari denied, 340 U.S. 875; *Helvering* v. *Kehoe*, 309 U.S. 277, 279; *Sterns* v. *Commissioner*, 235 F. 2d 584 (C.A. 9th); *Gobins* v. *Commissioner,* 217 F. 2d 952 (C.A. 9th); *Rose* v. *Commissioner,* 188 F. 2d 355 (C.A. 9th), certiorari denied, 342 U.S. 850, rehearing denied, 342 U.S. 889; *Davis* v. *Commissioner,* 239 F. 2d 187 (C.A. 7th); *Bodoglau* v. *Commissioner*, 230 F. 2d 336 (C.A. 7th); *Halle* v. *Commissioner*, 175 F. 2d 500, 503-504 (C.A. 2d), certiorari denied, 338 U.S. 949; *United States* v. *Gypsum Co.*, 333 U.S. 364, 394-395, rehearing denied, 333 U.S. 869; Rule 52(a), Federal Rules of Civil Procedure. As the court stated in *Na-*

tional City Bank of New York v. *Helvering*, 98 F. 2d 93, 96 (C.A. 2d):

> Although fraud must be well proved, the taxpayer has the burden of showing that the Commissioner was wrong and that the Board had no basis for its finding.

While "Fraud cannot be lightly inferred, but must be established by clear and convincing proof" (*Rogers* v. *Commissioner*, 111 F. 2d 987, 989 (C.A. 6th); *Bodoglau* v. *Commissioner*, 230 F. 2d 336 (C.A. 7th)), yet the obligation of the Commissiner to prove it relates only to the fraud penalty and not the correctness of the deficiency (*Cohen* v. *Commissioner*, 9 T.C. 1156, affirmed, 176 F. 2d 394 (C.A. 10th); *United States* v. *Chapman*, 168 F. 2d 997 (C.A. 7th)). Moreover, "there is no burden upon the Government to prove its case beyond a reasonable doubt." *Helvering* v. *Mitchell*, 303 U.S. 391, 403; *Spies* v. *United States*, 317 U.S. 492, 495.

Dispositive of the taxpayer's contentions that he was not guilty of fraud with intent to evade the payment of income taxes for the three taxable years involved (Br. 53-62) are the Tax Court's findings made upon all the evidence and not shown by the taxpayer to be clearly erroneous. Thus, the Tax Court found that the taxpayer had understated and failed to report taxable income in large amounts for all three taxable years involved. (R. 235, 236, 237, 244-248.) Specifically, the Tax Court found upon the evidence that the taxpayer had understated and failed to report taxable income in the total amounts of $110,204.87, $78,725.09 and $99,-792.29, aggregating $288,722.25, for the taxable years 1948-1950, respectively, over and above the total amount of $131,277.75—an annual average of only $43,759.25—

reported by him for those years, or an average understatement of income of more than $96,000 for each of the three successive years involved. (R. 220-221, 235, 236, 237.) This, quite clearly, is one of the most significant facts showing an intent to defraud, that is, the taxpayer's consistent, *continuing* failure to report substantial amounts of taxable income from year to year over the three-year taxable period involved. Paraphrasing the words of the Second Circuit in *Halle* v. *Commissioner,* 175 F.2d 500, 503, certiorari denied, 338 U.S. 949, a fraud case comparable in flagrancy, "The deficiencies here were too many, too varied, too continuous and too excessive to be plausibly attributed to inadvertence or carelessness * * * [and] were such in magnitude and importance that they could hardly have been overlooked by a prosperous * * * [businessman such as the taxpayer here]; and all the facts, set in their proper background, simply cry out against any such inference". As the Sixth Circuit said in this connection in *Rogers* v. *Commissioner*, 111 F. 2d 987, 989:

> It is conceivable that taxpayers may make minor errors in their tax returns, or, owing to different or contradictory theories of tax computation, calculate returns which differ greatly in result from the Commissioner's assessments. Here petitioners do not have that excuse. Discrepancies of 100 per cent and more between the real net income and the reported income for three successive years strongly evidence an intent to defraud the Government. The Board did not err in deciding that 50 per cent penalties should be assessed.

See also *Wood* v. *United States*, 16 Pet. 342, 360-361, holding that "fraudulent intent" or motive for a par-

ticular act may always be shown by "evidence of other acts and doings of the party, of a kindred character"; and see *Bodoglau* v. *Commissioner*, 230 F. 2d 336 (C.A. 7th); *Davis* v. *Commissioner*, 239 F. 2d 187 (C.A. 7th); *Rogers* v. *Commissioner*, 111 F. 2d 987, 989 (C.A. 6th).

On the record as a whole, the Tax Court concluded (R. 244-247) that—

> After a painstaking analysis of all of the evidence in this case, and bearing in mind the above-stated principles, we are convinced that petitioner received taxable income during each of the years 1948, 1949 and 1950 from his activities as betting commissioner in excess of that reported on his returns for those years, and that in each of said years a part of the deficiency was due to fraud with intent to evade taxes. * * *
> * * * we reach the conclusion that there was a substantial understatement of income on petitioner's return for each of the taxable years in question.
> * * * after resolving any doubts in this respect against respondent, with whom the burden of proof of fraud lies, we hold, upon our analysis of the record, that the understatements were substantial for each year before us. Our analysis likewise convinces us that a large part of the understatements in each of said years was attributable to petitioner's failure to include in his return the receipt of commissions in cash.
>
> * * * * *
>
> Here, in addition, petitioner failed to maintain records of his cash transactions, or of the cash commissions earned in such transactions, and kept uninformed the accountants whom he em-

> ployed to prepare the data for his returns and the returns themselves. Petitioner admits that his failure to maintain records of his transactions as betting commissioner was deliberate. The reason he assigns was to keep them from law enforcement officers on the lookout for illegal gambling activities. We have no doubt that [the taxpayer's] concealment from the tax authorities and evasion of taxes was a coordinate objective. * * * Petitioner was an educated man and could not have been unaware of his obligations as a taxpayer. * * *
>
> We think it clear, without going into further detail, that fraudulent intent to evade taxes must be inferred from petitioner's conduct as disclosed by the record.

Accordingly, the Tax Court thereupon found as ultimate facts (R. 221) that—

> Petitioner, in his income tax returns for each of the years in question, substantially understated income from his activities as betting commissioner and the operation of the Kingston Club card room. A part of the deficiency for each of the years involved was due to fraud on the part of petitioner with intent to evade taxes within the meaning of section 293(b) [of the Internal Revenue Code of 1939].

These findings, not shown by the taxpayer to be in anywise erroneous (Br. 53-62), are likewise entitled to finality under the same decisions already cited in this connection under Point I, *supra*. Moreover, the Tax Court, in so finding, was not unmindful of the requirements of the statute (Section 7454 of the Internal

Revenue Code of 1954, Appendix, *infra*) which places on the Commissioner the burden of establishing fraud, and, as pointed out, it found that the Commissioner had sustained this burden. (R. 248.) Indeed, the careful and discriminating opinion of the Tax Court (R. 243-248) shows clearly that it knew the applicable legal standards and knew how to apply them.

The taxpayer, in denying fraud (Br. 53-62), has overlooked or ignored certain specific requirements which all taxpayers are legally bound to abide by under controlling rules long since laid down by the Supreme Court in cases such as this. Thus, the Court stated in *Helvering* v. *Mitchell,* 303 U.S. 391, 399, that "In assessing income taxes the Government relies primarily upon the *disclosure by the taxpayer* of the relevant facts" in his tax returns, and "To ensure full and honest disclosure, to *discourage fraudulent attempts to evade the tax,* Congress imposes sanctions." [Italics supplied.] And in *Spies* v. *United States,* 317 U.S. 492, 495, 496, the Supreme Court also said that the "taxpayer's neglect or deceit may prejudice the orderly and punctual administration of the [Government's tax collections] system as well as the revenues themselves," in anticipation of which "Congress had imposed a variety of sanctions for the protection of the system and the revenues" lawfully due the Government; and *Hence the willful failure to * * * supply information when required,* is made a misdemeanor, without regard to existence of a tax liability." [Italics supplied.] Likewise, the courts have held in respect of the Government's tax collection system that "Its efficiency must depend largely on the *truth of facts* set out by the taxpayer in his return." [Italics supplied.] *Halle* v. *Commissioner,* 175 F. 2d 500, 502 (C.A. 2d), certiorari

denied, 338 U.S. 949. See also *Holland* v. *United States*, 348, U.S. 121, 132, rehearing denied, 348 U.S. 932.

As the court stated in *Davis* v. *Commissioner*, 239 F. 2d 187, 188 (C.A. 7th), "consistent, substantial understatement of income is highly persuasive evidence of intent to defraud." See also *Bodoglau* v. *Commissioner*, 230 F. 2d 336 (C.A. 7th). Many cases have held that a taxpayer's failure to report substantial amounts of net income on his income tax return consistently from year to year is in itself convincing evidence of fraud. *Gobins* v. *Commissioner*, 217 F. 2d 952 (C.A. 9th); *Sterns* v. *Commissioner*, 235 F. 2d 584 (C.A. 9th); *Rose* v. *Commissioner*, 188 F. 2d 355 (C.A. 9th), certiorari denied, 342 U.S. 850, rehearing denied, 342 U.S. 889; *Humphreys* v. *Commissioner*, 125 F. 2d 340 (C.A. 7th), certiorari denied, 317 U.S. 637; *Rogers* v. *Commissioner*, 111 F. 2d 987, 989 (C.A. 6th); *Hoefle* v. *Commissioner*, 114 F. 2d 713 (C.A. 6th); *Battjes* v. *United States*, 172 F. 2d 1, 5 (C.A. 6th); *Halle* v. *Commissioner*, 175 F. 2d 500, 504 (C.A. 2d), certiorari denied, 338 U.S. 949; *Heyman* v. *Commissioner*, 176 F. 2d 389, 393-394 (C.A. 2d), certiorari denied, 338 U.S. 904; *Mitchell* v. *Commissioner*, 89 F. 2d 873 (C.A. 2d), reversed on other grounds, 303 U.S. 391 [16]; *Schwarzkopf* v. *Commissioner*, 246 F. 2d 731 (C.A. 3d); *Mauch* v. *Commissioner*, 113 F. 2d 555, 557 (C.A. 3d); *Harris* v. *Commissioner*, 174 F. 2d 70 (C.A. 4th); *Stinnett* v. *United States*, 173 F. 2d 129 (C.A. 4th), certiorari

[16] In the *Mitchell* case the Second Circuit held that there was ample evidence to sustain the finding of the Board of Tax Appeals (now the Tax Court) that there was fraud with intent to evade the tax, but that Mitchell's prior acquittal on the charge of violation of a criminal statute relating to fraudulent evasions of income taxes prevented the imposition of the 50% fraud penalty. The Supreme Court reversed on that issue.

denied, 337 U.S. 957; *Schuermann* v. *United States*, 174 F. 2d 397, 399 (C.A. 8th), certiorari denied, 338 U.S. 831, rehearing denied, 338 U.S. 881; *Cooper* v. *United States*, 9 F. 2d 216, 222 (C.A. 8th). See also *National City Bank of New York* v. *Helvering*, 98 F. 2d 93 (C.A. 2d), where the court held (p. 96) that the evidence, that the corporate officer there accepted the bonds as an illicit bonus or commission on the contract negotiated by him and treated them as his own during the particular years involved, was sufficient to authorize penalizing him for fraud for having omitted the bonds from his income tax returns for those years. Moreover, it was long ago aptly stated in *Commissioner* v. *Dyer,* 74 F. 2d 685, 686 (C.A. 2d), certiorari denied, 296 U.S. 586, that "Could any doubt exist, it is laid to rest by the repetition of the ritual in the second year." Here there was repetition by the taxpayer in the second and third years.

As to the taxpayer's contention here (Br. 53-54), as in the Tax Court, that the Commissioner allegedly failed to meet his burden of proving intent to defraud, we submit that the taxpayer here "may be presumed to intend the necessary and natural consequences of his acts," as the Eighth Circuit held in *Myres* v. *United States*, 174 F. 2d 329, 344, certiorari denied, 338 U.S. 849. As the Tax Court said (R. 244):

> We also recognize that in this, as in many fraud cases, the proof of fraud, if it is to be established, must depend in some respects upon circumstantial evidence. Fraudulent intent can seldom be established by a single act or by direct proof of the taxpayer's intention. It is usually found by surveying his whole course of conduct and is to be ad-

duced as any other fact from all the evidence of record and inferences properly to be drawn therefrom. *M. Rea Gano,* 19 B.T.A. 518 (1930).

Moreover, as already shown, a consideration of all the evidence affords clear and convincing proof that the taxpayer knowingly and "consistently cheated the Treasury" in evading his income taxes for all three taxable years involved. *Seifert* v. *Commissioner*, 157 F. 2d 719 (C.A. 2d). As stated by the court in *Heyman* v. *Commissioner*, 176 F. 2d 389, 394 (C.A. 2d), certiorari denied, 338 U.S. 904, "We think the situation as a whole was shown to have been instinct with fraud and that the finding of the Tax Court, far from being erroneous, was plainly right." It follows, we submit, that the Commissioner's determination and the Tax Court's finding of fraud with intent to evade taxes must be accepted as correct.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted,

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APPENDIX

Internal Revenue Code of 1939:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, business, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

(26 U.S.C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687] *General Rule.*—The

amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 42.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

(26 U.S.C. 1952 ed., Sec. 54.)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * *

(26 U.S.C. 1952 ed., Sec. 276.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum

of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612(d)(2).

(26 U.S.C. 1952 ed., Sec. 293.)

Internal Revenue Code of 1954:

SEC. 7454. BURDEN OF PROOF IN FRAUD AND TRANSFEREE CASES.

(a) *Fraud.*—In any proceeding involving the issue whether the petitioner has been guilty of fraud with intent to evade tax, the burden of proof in respect of such issue shall be upon the Secretary or his delegate.

* * * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 7454.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.22(a)-1. *What Included in Gross Income.* —Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. * * *

* * * * *

Sec. 29.41-1. *Computation of Net Income.*— * * * If the taxpayer does not regularly employ a method of accounting which clearly reflects his income, the computation shall be made in such manner as in the opinion of the Commissioner clearly reflects it.

Sec. 29.41-3. *Methods of Accounting.*—It is recognized that no uniform method of accounting can be prescribed for all taxpayers, and the law contemplates that each taxpayer shall adopt such forms and systems of accounting as are in his judgment best suited to his purpose. Each taxpayer is required by law to make a return of his true income. He must, therefore, maintain such accounting records as will enable him to do so. * * *

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Sec. 29.54-1. *Records and Income Tax Forms.*—Every person subject to the tax, except persons whose gross income (1) consists solely of salary, wages, or similar compensation for personal services rendered, or (2) arises solely from the business of growing and selling products of the soil, shall, for the purpose of enabling the Commissioner to determine the correct amount of income subject to the tax, keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of the gross income and the deductions, credits, and other matters required to be shown in any return under chapter 1. Such books or records shall be kept at all times available for inspection by internal-revenue officers, and shall be retained so long as the contents thereof may become material in the administration of any internal-revenue law.

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